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Impact of Rising Food Prices - EU 27

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Report Highlights:

Rising food and commodity prices have been the subject of heated political debate among the governing bodies of the European Union. This report summarizes some of the basic elements of this debate within the context of the EU Common Agricultural Policy (CAP). As the EU-27 Member States collectively help shape the CAP, and often implement it within the context of local conditions, this report should be read in conjunction with other GAIN reports from EU Member States Capitals.

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Rising food and commodity prices have been the subject of heated political debate among the governing bodies of the European Union (EU). Since 1963, the EU Common Agricultural Policy (CAP) has been the foundation of the Member States (MS) food and agriculture programs. While CAP instruments are evolving through a lengthy reform process, the emphasis of the CAP is on production policy. EU MS are very active in helping to shape the CAP, and are responsible for implementation. Therefore, this report should be read in conjunction with the reporting from MS capitals.

Demand

According to the most recent EU data available, in 2006, the average EU-27 household spent 12.7 percent of its expenditures on food and non-alcoholic beverages. However, in the new EU Member States, households tend to spend proportionately more on food, with percentages varying from 15 to 30 percent. EU surveys indicate that households with lower income tend to spend a larger share of the total household budget on food.

According to the European Consumers' Organization, households with the lowest income also have the poorest diets. In March 2008, the European Commission initiated a consultation process for an impact assessment on the future of the EU "Food Distribution to the Most Deprived Persons in the Community." This scheme, which provides surplus food stocks to charities in the Member States, was introduced in 1986-87, during an exceptionally cold winter. With the CAP reform process, many EU intervention stocks are very low, or have disappeared altogether. The EU impact assessment is expected to consider possible options for providing food to the most deprived.

Supply

Historically, EU food production has been heavily influenced by the CAP. However, through successive CAP reforms, farm support payments have become increasingly decoupled from production. As a result, production for many previously price supported commodities has declined to levels at or below self-sufficiency. This is true especially in animal production, with the exception of pork, which has always been one of the least regulated sectors. Diseases, such as avian influenza, have also had an adverse effect on animal production. For grains, repeated droughts have also had an impact on supply. With EU intervention stocks falling steadily, or completely disappearing, the EU has become a net importer for several important commodities: protein feedstuffs, vegetable oil, beef and, as of 2008, poultry. In the past year, the European Commission relaxed production restriction measures for grains (the zero set-aside) and for dairy (through a production quota expansion).

The current high price situation for grains and oilseeds is expected to accelerate the implementation of the remaining CAP reforms, especially encouraging the recently acceded Member States to modernize and increase production. Higher input costs in areas such as fertilizers, phytopharmaceuticals and energy will be a significant constraint. In the animal production sectors, with increasing feed costs, EU producers struggle to remain competitive. The EURO/USD exchange rate has also been a disadvantage, particularly to EU pork producers who depend on exports. To alleviate some of this pressure, the European Commission has reinstituted some export subsidies.

Food Prices

Article 121 of the EU Treaty requires reporting on the degree of EU convergence for macroeconomic indicators, such as inflation. The EU's Harmonized Indices of Consumer Prices (HICPs) are compiled for all Member States. Over the period October 2006 to September 2007, the HICP for the EU 27 indicated a 3.3 percent increase for food, compared

to a 2.2 percent increase for all items. However, looking at the period April 2007 to March 2008, the HICPs for EU-27 indicates a 6.1 percent increase for food, compared to a 3.2 percent increase for all items over the same period.

Environmental Impact

An EU policy of land set-aside was introduced in 1992, with the objective of taking more vulnerable and less productive land out of production. The EU set-aside area has had a positive effect on environmental protection, and has provided refuge for wildlife. However, with declining EU production and an increased EU demand for biofuels feedstock, the European Commission plans to eliminate land set-aside. This policy has been strongly criticized by environmental NGOs.

Biofuels

The European Commission's biofuels policy to introduce a binding 10 percent target for biofuels utilization in transport fuel by 2020 is also drawing a lot of criticism. Some food companies have been very vocal in suggesting that the growth in biofuels has had an effect on the availability of raw food commodities, with an obvious impact on prices. Several of these companies have also echoed the concerns of environmental NGOs over the issue of sustainability. On issues like deforestation, food companies appear eager to focus public attention on the social cost of biofuels production. However, food companies cannot easily disguise their self-interest in maintaining easy access to low priced raw commodities. The political pressure to ensure sustainable development is also evident in the European Commission's proposal on biofuels, where sustainability criteria are under debate for both domestic production and imports.

Biotechnology

The EU continues to strictly regulate all aspects of policy on biotechnology. However, EU Member States exercise a significant degree of freedom in interpreting the EU's regulatory framework, and in implementing rules on coexistence. Many EU Member States remain very strongly opposed to the import and production of GM crops, and have even instituted bans despite positive recommendations by the European Food Safety Authority and the European Commission. A WTO case brought by the United States, Argentina and Canada found that the EU's biotech approval process and MS bans were inconsistent with obligations under the WTO SPS Agreement.

Livestock

Rising global dairy prices are not expected to trigger a large increase in EU dairy production. Although EU quota limitations remain in place, there will certainly be an incentive to focus on value-added production, notably cheese. Profitability in the EU pig meat sector has been seriously affected by the high feed prices, reportedly 35 percent higher than the previous year. The problem has been compounded by the strength of the EURO against the dollar, which has affected EU pig meat exports to third markets. To help manage an oversupply of pig meat, the EU introduced a private storage aid scheme in October 2007. Under this program, processors can remove pork from the market for 3-5 months. In November 2007, EU pig breeders staged demonstrations demanding support payments. The European Commission responded by reinstituting export refunds to encourage pork exports.

11. (U) Grains: UK cereal production for 2007/08 has fallen almost 9 percent due to adverse weather conditions. Spain also continues to report drought concerns throughout

the Iberian Peninsula. Resulting higher grain prices have triggered price increases for many basic staples. In November 2007, Italians took to the streets to protest price increases for pasta. Italy is the world's largest importer of durum wheat, which is used for pasta production. Grain price increases led the European Commission to suspend grain import duties for the 2007/08 marketing year.

12. (U) Oilseeds: Over the last year, EU-27 oilseed production has also been strongly influenced by weather. Although EU-27 production levels did not decline significantly in 2007/08, the oilseed deficit is expected to widen as demand, particularly for the production of biodiesel, continues to be very strong.

13. (U) The Future of the CAP: Notwithstanding the recent CAP reforms, EU agricultural policies still have some distortionary effects on EU prices for a number of products (for example, milk, beef and sugar). The European Commission is proposing to accelerate the process of decoupling – eliminating the direct link between farm payments and production. The CAP reforms are also intended to improve market efficiency, offering lower prices to European consumers. On May 20, 2008, the European Commission will publish its legislative proposals on the "Health Check of the CAP," a review of the CAP reform implementation through 2013.

14. (U) European Parliament: With the implementation of the EU Lisbon Treaty, starting January 1, 2009, the European Parliament will become an equal partner in the decision-making process for most food and agricultural policy issues. On April 22, 2008, the European Parliament held a debate on the issue of rising food prices. A number of speakers held the view that food price increases were not tied to biofuels production. Joseph Daul, a Member of European Parliament, underscored the point that EU biofuels production represented only about 2 percent of the EU's agricultural production, and therefore could not be the main cause for the rise in food prices. On the issue of biotechnology, Mr. Daul noted that: 'We [the EU] should be thinking seriously about GMOs'. The European Parliament is scheduled to pass a Resolution on the food price issue at its May plenary session.

15. (U) International Response: On April 22, 2008, EU Commissioner for Development and Humanitarian Aid Louis Michel announced a 60 million EURO aid package (\$93.5 million) to help mitigate the impact of higher food prices in developing countries. Commissioner Michel has dubbed the current crisis a 'humanitarian tsunami', which has slowly eroded aid agencies ability to provide food to those most in need. In addition to the 60 million EURO, the Commission has advanced 57.25 million EURO (\$89 million) from their emergency food aid budget to assist the most vulnerable. To date, the total obligated EU humanitarian food aid budget for 2008 is 283.25 million EURO (\$441 million). The EU is currently conducting on the ground assessments to determine the level and nature of needs resulting from food inflation. An internal EU task force has started to formulate budget requests.

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